

Domestic Production Activities Deduction

Internal Revenue Code Section 199

Added by the American Jobs Creation Act of 2004 (P.L. 108-357), Internal Revenue Code Section 199 allows taxpayers the Domestic Production Activities Deduction - which is a deduction for income attributable to domestic production activities. The deduction is effective for tax years beginning in 2005 and thereafter. According to federal income tax law, a taxpayer engaged in a qualified production activity (QPA) may claim a deduction against gross income equal to the applicable percentage of its qualified production activities income, with certain limitations.

Alabama Treatment for Income Tax and Financial Institutions Excise Tax (Issued: January 1, 2006)

Corporations:

Corporations subject to Alabama corporate income tax law are allowed the deduction. The computation of corporate taxable income according to Alabama income tax law is tied to federal taxable income (see Section 40-18-33, Code of Alabama 1975). See also *Multistate Allocation and Apportionment Reporting Requirements*, below. For federal purposes, this new deduction is computed at the federal (super) consolidated group level and then allocated back to group members. The Alabama Department of Revenue anticipates difficulties in allocating the deduction to group members in order to calculate separate company federal taxable income, the starting point for calculating Alabama taxable income. We have been, and will continue to, monitor the developing federal rules applicable to the allocation.

Individuals:

Individual taxpayers subject to the Alabama individual income tax law are not allowed to claim the Domestic Production Activities Deduction in computing the taxpayer's Alabama taxable income. The deduction is not allowed to individual taxpayers even if the individual taxpayer is an owner or shareholder of a pass-through entity which has gross receipts derived from qualifying production activities (QPA). Unlike Alabama's corporate income tax, Alabama's individual income tax is not directly tied to federal taxable income. A statutory change to Alabama's individual income tax law would be required to conform to this new federal deduction.

Financial Institutions:

Financial institutions, as defined in Section 40-16-1, Code of Alabama 1975, are not allowed to claim the Domestic Production Activities Deduction in computing the tax owed for the Alabama Financial Institutions Excise Tax. A financial institution is not allowed to claim the deduction even if the financial institution is an owner or shareholder of a pass-through entity which has gross receipts derived from qualifying production activities (QPA). Unlike Alabama's corporate income tax, Alabama's Financial Institutions Excise Tax is not directly tied to federal taxable income. A statutory change to Alabama's Financial Institutions Excise Tax law would be required to conform to this new federal deduction.

Pass-through Entities:

Alabama pass-through entities (S-corporations, subchapter K entities, and trusts) do not take the Domestic Production Activities Deduction, but rather report (as a separately stated item) the information required for computing the Domestic Production Activities Deduction to pass-through entity owners and shareholders. See also *Multistate Allocation and Apportionment Reporting Requirements*, below.

Pass-through entity owners and shareholders who are individuals or financial institutions, as defined in Section 40-16-1, Code of Alabama 1975, are not allowed to claim the Domestic Production Activities Deduction. See also *Individuals* and *Financial Institutions*, above.

Multistate Allocation and Apportionment Reporting Requirements:

There are no special Alabama allocation and apportionment reporting requirements for the Domestic Production Activities Deduction.

The Alabama Department of Revenue will publish on its website (www.revenue.alabama.gov) any new updates concerning the Alabama tax treatment of the Domestic Production Activities Deduction.